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TAGS: ECON EFIN ETRD EINV EIND PREL PGOV CA
SUBJECT: Canadian Finance Minister Announces Canadian Economy
Restored to Pre-Recession Growth and Deficit Levels by 2015

Ref: Ottawa 0116

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¶1. (SBU) Summary: The Canadian government's plan to eliminate the nation's budget deficit and return to pre-recession growth rates by 2015 without cutting spending or raising taxes is leaving some economists scratching their heads. Ottawa observers suggest that the optimistic forecast is an attempt by the Harper government to bolster support for its economic recovery plan in anticipation of a possible autumn election. End summary.

Canada's Milder Recession

¶2. (U) Canadian Finance Minister Jim Flaherty released the government's quarterly Update of Economic and Fiscal Projections on September 10, 2009. The report contained revised growth, debt and inflation projects based on the government's own analyses and combined with those of private (mostly banking) sector economists. The government predicts a near-complete economic recovery within five years.

¶3. (SBU) Since the onset of the global recession last autumn, both the Finance Ministry and the Central Bank have presented very optimistic assessments of the state of Canada's economy (reftel). These estimates have regularly been revised downward shortly after their release but also after media attention has moved on to other issues. Ottawa watchers speculate that the government's effervescent forecasting has been meant to bolster public and investor confidence. The impact of the recession has been less severe in Canada because of the strength of the financial and energy sectors and limited exposure to sub-prime credit instruments. Canada's relatively strong position among the G8 economies has helped the government to justify its 'glass half-full' messaging even during the worst days of the economic crisis. To be fair, in the early-mid stages of the recession, it was difficult for policymakers here (or anywhere) to make accurate near-term predictions; in Canada, when they did do so, they adopted the rosier possible outcomes.

Growth and Fiscal Predictions

¶4. (U) In February, Bank of Canada Governor Mark Carney forecast a 1.2 percent contraction of the Canadian economy in 2009 followed by

a 3.8 percent rebound in 2010. By July, the government's estimates of the recession's magnitude nearly doubled for 2009 to 2.3 percent. Similarly the hopes for growth in 2010 were scaled back to 3.0 percent. (Private sector forecasters are suggesting that Canada should expect somewhere in the region of 2.5 percent growth in 2010). The Central Bank also predicted in July that economic growth in Canada would turn positive in the third quarter of 2009. Right on schedule, Prime Minister Harper announced on September 20 that the recession had technically ended. However, he warned that the recovery was fragile while unemployment remains at its highest levels since 1998 at 8.7 percent.

¶5. (U) On the fiscal side, the government now predicts that the budget deficit will peak in 2010 at C$55.9 billion and then decrease incrementally to around C$5.2 billion in 2014 (disappearing entirely in 2015). Minister Flaherty notes that with overall government spending estimated at about C$300 billion in 2014, C$5.2 will be a
Qspending estimated at about C$300 billion in 2014, C$5.2 will be a
modest challenge to deal with in the overall context. Comment: The last time the budget was in deficit was in 1997 and Canadians are wary about returning to a period of persistent deficits that could affect national credit status. End comment.

¶6. (U) While growth rates and the deficit are predicted to return to pre-recession levels by 2015, the lingering legacy of the economic crisis will be an increased national debt - estimated to climb from C$464 billion in 2009 to C$628 billion in 2014, if government forecasts are correct.

Econo-magic

¶7. (SBU) The government plans a six-year recovery period for the

Canadian economy without raising taxes or cutting program spending. Given that these statements were made just prior to a critical vote in the Canadian Parliament that could have defeated the Harper government, EMIN sought the views of economists outside of the Finance Ministry for an alternative assessment of the government's predictions. The two economists (one from a government crown corporation and the other from an Ottawa-based think tank) said it was their understanding that the Prime Minister's advisors had instructed Finance officials to construct a scenario in which the deficit could be eliminated without taxes or cutting spending. To achieve this, Finance Canada economists aggregated a number of best-case projections for how the deficit could be eroded through a combination of inflation and increased tax revenues generated through economic expansion. While the resulting analysis provided the Prime Minister with the economic story he was after, EMIN's contacts were skeptical about the government's capacity to deliver on its promises.